

EXHIBIT

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Long Range Planning

Good Morning. My name is Dave Cole. I am the Administrator of the Community Development Division at the Department of Commerce. Also with me today is Jim Edgcomb, Manager of the Treasure State Endowment Program (TSEP).

Our division has three infrastructure grant program: the Coal Board, which began in 1975, the Community Development Block Grant Program (CDBG), which began in 1982, and the Treasure State Endowment Program, which was approved by Montana voters in June, 1992. Cathy Duncan asked me to offer a broader perspective on the role that grant programs play and on the relationship of the CDBG program to TSEP.

The passage of the federal Safe Drinking Water Act of 1974 and the Clean Water Act of 1977 increased pressure upon communities to improve their drinking water and wastewater treatment systems. Before that communities were reluctant to push infrastructure forward because there were so few options to reduce the costs to local residents. Conventional municipal bonds were very costly for small communities, in particular.

In 1981, President Ronald Reagan offered several federal programs to the States through his concept of "New Federalism". One of those was the "Small Cities" Community Development Block Grant (CDBG) Program for local governments under 50,000 population. We held a series of ten public meetings across the State to see what Montana local officials thought about the State taking over the program. Under federal administration by the U.S. Department of Housing and Urban Development (HUD), the principal focus of CDBG was housing. They let us know very clearly that what they needed help with was financing water and wastewater projects to comply the new federal requirements. As a result, the September, 1981 Special Session of Legislature voted to authorize Department of Commerce (DOC) to administer the program.

One thing that is important to understand is that CDBG is more limited in who it can serve than TSEP. Under federal law, all CDBG projects must principally benefit low and moderate income persons. That is really a misnomer because the definition of "moderate" means 80 per cent of median family income. Another HUD program, which uses the same income limits, uses the terms "very low and low income" which is more accurate. For community-wide projects, like water or wastewater systems, the community must be overall 51% or greater low and moderate income. Under this limit, about two-thirds of Montana communities are eligible to apply, although many communities under the 51% level do income surveys to demonstrate their eligibility. Because of the emphasis on serving lower income persons, special purpose projects which by their nature serve higher proportions of lower income people like senior centers, nursing homes,

shelters for abused women or kids or the mentally ill, or Head Start centers can rank higher under CDBG guidelines than community-wide water and wastewater projects that serve the entire community population.

About the same time that Commerce was beginning to administer the State CDBG Program, the Department of Natural Resources and Conservation was implementing the Water Development Program that I believe was established by the 1981 Legislature. I understand that Representative Francis Bardanoue saw the program as a means of supporting agricultural water development for storage and irrigation projects through grants and low interest loans. Instead, it was mostly communities that applied to the program for help in financing water and wastewater projects.

Commerce and DNRC began cooperating in putting on application workshops for our programs. That led to the creation of the Water and Sewer Agencies Coordinating Team (WASACT) in 1982, which continues today. WASACT is considered a model of interagency cooperation for other states because it includes all the major state and federal infrastructure funding agencies. It has developed common application forms, a common environmental assessment form, and standard requirements for the content of preliminary engineering reports that all the agencies can use to review proposed projects. The agencies coordinate in presenting joint application workshops and pool their resources to publish handbooks and videos to explain the process of planning for and financing major public facility projects. Several other states have since established coordinating groups based on the WASACT example. (HAND OUT WASACT CHART AND EXAMPLES)

One of the underlying challenges for financing water and wastewater projects is simple arithmetic. The smaller the community is, the more difficult it is because you have fewer users to spread the costs across. Even for small communities, because of the sophisticated treatment systems now required to meet federal and state standards it can easily cost one to two million dollars for a project. That's why for the CDBG and TSEP grant programs, it tends to be smaller communities that make up the majority of the applicants. In addition, the limited grant amounts we have for the programs really do not have that much of an impact on user cost for larger cities because the total cost of their projects is typically so much larger.

Selling a major water or wastewater project to a community is always a challenge. That was particularly true in the 1980's when CDBG was new and most

communities had kept their user charges at low rates. Many communities experienced real sticker shock at the cost increases that were necessary to fund their projects, even with the available grants to reduce the cost of borrowing. We had at least six projects that turned down grant-loan packages that were better than you would ever see today. One of our first CDBG grants in 1982 was to a community with very low rates, probably not even enough to cover the true costs of operation and maintenance, let alone the costs of eventually replacing the system. The town council was under such pressure because the rates were going to have to triple that they agreed to a referendum that voted down a dream funding package that was 75% grant funds. In another small town, the mayor and town council lost their seats to an anti-project slate of candidates because of the perceived high cost to rate payers. In another small town, the Mayor and entire council resigned because of the intense pressure they were under. Opponents even organized a boycott of the Mayor's business. We had to find an obscure state statute that allowed Governor Schwinden to appoint a new Mayor who could appoint council members willing to serve.

The problem was that each community was its own universe and there was no yardstick to say how much a community should reasonably be paying for water and wastewater services. It was at this point in 1992, in preparing for the first TSEP funding cycle that the CDBG and new TSEP staff, with the help of financial consultants, developed the "target rate" system that we now use to determine what each community should be paying for water and wastewater system. You will hear the term many times next week and it is a very important one because it has changed how local governments finance their projects when they use CDBG or TSEP funds.

It is really an attempt to answer the question posed by Rep. Ernest Bergsagel when he chaired Long Range Planning during the first TSEP funding cycle in 1993: "What is the community's fair share of a project?" He said the State should not be in the business of over subsidizing local projects. The concept is based on the idea that a community's ability to fund a water or wastewater project is based on the overall incomes in that community, as reflected by the median household income. We conducted statewide surveys of what communities with recently improved systems were actually paying, which allowed us to establish target rates for water and wastewater projects based on a percentage of the community's median household income. Local ratepayers may grumble about what the target rate asked them to contribute to fund their project but for the first time, there was an objective statewide standard that could be applied to

everyone. That has largely ended the problem of local rate payer revolts. The "target rate" system is now considered a model by other states.

(1.4% for water systems plus .9% for wastewater systems equals 2.3%).

During the last session, during the TSEP hearings, legislators often asked if the projects were "ready to go". In most cases, they are not. Communities usually apply for grant funds first, such as TSEP and CDBG, so they can figure out if they can afford the cost of a loan. TSEP is clearly the first preference of communities, because it has far fewer regulations and higher grant ceilings than CDBG. CDBG, as a 35-year-old federal program, has accumulated a lot of requirements after many sessions of Congress and regulations imposed by the HUD bureaucracy.

(CDBG FUNDING CHART) The Bush years have not been very kind to the CDBG program. Even though it was originally conceived by a Republican administration, under President Ford, and was re-energized by President Reagan when he turned it over to the States, President Bush tried to kill the CDBG Program out right early in his administration. When that did not succeed, the Bush budgets have cut funding back year after year. Last year, with an increase of Democratic seats, Congress resisted the additional 21% cut Bush called for and actually increased funding over the previous year. The President called for another 23% cut in the program for federal fiscal year 2009. In contrast, the Obama platform called for a return to full funding for CDBG but did not state what that meant.

The national budget for CDBG is divided two-thirds for the Entitlement communities over 50,000 like Billings, Great Falls, and Missoula. One-third is reserved for the State CDBG Program. Recently, a group of several major national organizations of counties, cities, and states has been lobbying for a budget of \$5 billion nationally for CDBG that would represent a 25% INCREASE in funding. On Wednesday, our CDBG program manager met with Senator Baucus in Washington who told him that CDBG would likely be part of the Stimulus Bill. The budget for CDBG that has been mentioned is \$10 billion, which would provide Montana about \$20 million. At that amount, rather than funding only eight of the 20 public facility applications we received this summer, we could fund all of them. Since 17 of them are also TSEP projects, that could make a big difference for them in meeting the "shovel ready" criteria of the Stimulus Bill.

Once, early in my career with CDBG, I asked a wastewater program manager at the former Department of Health & Environmental Sciences if, after spending

millions every year, we would ever be done with most of the needs for water and wastewater projects. I figured out the answer was "no" before he stopped laughing. As long as federal and state standards keep getting tougher and as long as complicated treatment systems, water distribution lines, and sewage collection lines wear out, the need for infrastructure improvements will be with us.

What happened last session and this is a good example: in 2007, the Legislature funded all but one, 56, of the applications submitted to TSEP. This session, even though a few of the 2007 applicants re-applied we still have a record number of entirely new applications for TSEP funding. Even with the millions we are spending, we are not meeting all the infrastructure needs out there. The press tells us that the Stimulus Bill would be the biggest investment in infrastructure since the days of the Works Progress Administration during the Depression. The fact is that many of our projects are replacing deteriorated water and sewer lines that were first installed then by WPA, roughly 75 or more years ago.

Engineers tell us that the real elephant in the room is the large number of aged water and sewer lines in the original core areas of our cities and towns that are the original installations dating back 100 years.

The other infrastructure need that we hear about from homebuilders and local planners is the tremendous need for infrastructure to accommodate new growth. Most of what CDBG and TSEP projects deal with are treatment systems or water and sewer lines to serve existing development. Homebuilders complain that they cannot build affordable housing if they, and ultimately the homebuyer, have to pay the entire cost of installing water and sewer services. Our Housing Division figures that roughly 30% of the cost of a home served by a municipal system involves provision of water and sewer service and streets. The alternative that we see so often is that developers head just outside cities to build subdivisions where water and wastewater is handled by individual wells and septic systems. We know that this might well be creating tomorrow's water quality problems when we try to dispose of our wastes in the same ground that we pump our drinking water from.

This is an endless challenge but it is an important one. The Treasure State Endowment Program is truly the envy of our sister states. Just consider where Montana communities would be without it. We can't fund every project that comes to us but Commerce CDBG and TSEP staff make every effort to make sure the applications are reviewed fairly, consistently, and professionally. We truly appreciate the Legislature's support for both these programs. If you have any question, I would be glad to try to answer them.